KPERS Pension Funding Bonds

Pension Funding Bonds

Proceeds from pension funding bonds immediately improve the funded status of the Retirement System. The State takes on bonded debt with the expectation KPERS investment returns will exceed the interest rate paid on the bond issue.

Past Bond Issues

The State has twice issued pension funding bonds including:

1. **$500 million bond issue in 2004.** KPERS received about $440 million in total bond proceeds. The $500 million was authorized gross of fees and included capitalized interest. The 30-year bonds were sold at a 5.39% interest rate. Annual debt service is about $33 million and is funded from the Expanded Lottery Act Revenues Fund.

   KPERS investment return since the receipt of the 2004 bond proceeds in March 2004 is 7.72%. <u>The total value added, after payment of debt service, is about $482 million.</u>

2. **$1.0 billion bond issue in 2015.** KPERS received $1.0 billion in total bonds proceeds. The $1.0 billion was authorized net of fees, which totaled about $5 million. The 30-year bonds were sold at a 4.68% interest rate. Annual debt service is about $65 million and is funded from the State General Fund.

   KPERS investment return since the receipt of the 2015 bond proceeds in August 2015 is 8.64%. <u>The total value added, after payment of debt service, is about $293 million.</u>

With 13 and 24 years remaining on the debt service schedules, the net impact of the two bond issues will not be known for some time. But so far, both bond issues have been a net positive to the State.

KPERS 25-year investment return as of January 31, 2021 was 7.9%.

House Bill 2405

HB 2405 authorizes an additional $1.0 billion in pension funding bonds if the total interest rate is 3.5% or lower. However, if the total interest rate is between 3.5% and 3.75%, only $500 million in bonds would be authorized. The bond proceeds fund a portion of the unfunded actuarial liability, which totaled $6.5 billion for the State/School group on 12/31/2019.

An additional $1.0 billion in the KPERS Trust Fund would improve the funded ratio of the State/School group by almost 5%, <u>increasing from 71.9% funded to 76.7%</u> in the 12/31/2021 actuarial valuation.

Applying the additional proceeds in the 12/31/2021 actuarial valuation impacts the FY 2024 State/School employer contribution rates. The State/School employer contribution rate is projected to decrease from 13.69% to 12.03%, a difference of 1.66% or about <u>$90 million less in employer contributions</u>.

The annual debt service cost on a 30-year, $1.0 billion bond issue at a 2.75% interest rate is approximately $48.5 million.

KPERS

March 2021

MEMORANDUM

To: Senate Ways and Means Committee

A.D.C.

From: Alan D. Conroy, Executive Director

Date: March 22, 2021

Subject: Testimony in Support of House Bill 2405; Pension Funding Bonds

Board Support
The KPERS Board of Trustees has no position on the policy decisions of pension funding bonds, but strongly supports any legislative action that improves the funded status and sustainability of the KPERS System.

Bill Provisions
HB 2405 authorizes the Kansas Development Finance Authority (KDFA) to sell one or more series of revenue bonds of $1,000,000,000, net of fees, for deposit in the KPERS Trust Fund. The proceeds are to be applied to the KPERS unfunded actuarial liability.

For purposes of HB 2405, the unfunded actuarial liability is specifically defined as the unfunded actuarial liability of the KPERS School group. However, for funding purposes the State and School groups are combined so the addition of $1,000,000,000 impacts the State/School employer contribution rate.

The bill stipulates that the State Finance Council must approve a resolution stating the parameters for principal, interest rates and final maturity of the bond issuance. However, the bill language as introduced sets a maximum total interest rate of 3.5%.

HB 2405 stipulates that the bonds are solely the obligations of KDFA and are not an obligation or indebtedness of KPERS. KDFA and the Department of Administration are responsible for establishing debt service payment for the bond issuances.

The current estimated annual debt service on a 30-year, taxable bond issue of $1,000,000,000 at 2.75% is $48.5 million.

House Amendments
The House Insurance and Pensions Committee amended the bill by adding authorizing for a $500 million bond issue if the total interest rate is higher than 3.5% but does not exceed 3.75%.

KPERS

Actuarial Cost Impact
The addition of $1,000,000,000 to the Trust Fund in CY 2021 has both immediate and long-term impacts on the funding of the State/School Group.

The additional assets in the Trust Fund immediately improve the funded ratio of the State/School group. Under the current financing plan, the State/School is projected to be 71.9% on 12/31/2021. With the addition of the bond proceeds the funded ratio is projected to be 76.7%, or 4.8% higher.

The unfunded actuarial liability is estimated to decrease from $6.05 billion on 12/31/2021 under the current financing plan to $5.01 billion after the bond proceeds are deposited. The difference is slightly more than $1.0 billion on 12/31/2021 because the projection assumes the bond proceeds will be received in July and is accounting for 6 months on interest earnings on the bond proceeds.

HB 2045 does not change the financing schedule of the unfunded actuarial liability. The unfunded actuarial liability is still scheduled to be funded by 2035. However, with the additional assets from the bond proceeds, the amount of State/School employer contributions required to extinguish the unfunded liability is less.

The $1.0 billion in bond proceeds would first be reflected in the 12/31/2020 actuarial valuation, which sets employer contribution rates for FY 2024. Projected state/school group contribution rates for FY 2023 through FY 2028 are summarized below.

KPERS State/School Employer Contribution Rates				
Fiscal Year	Current Financing Plan	HB 2405	% Difference	$ Difference (in millions)
FY 2023	13.86%	13.86%	0.00%	$0
FY 2024	13.69%	12.03%	-1.66%	$(87.58)
FY 2025	13.52%	11.84%	-1.68%	$(90.83)
FY 2026	13.57%	11.87%	-1.70%	$(94.26)
FY 2027	13.17%	11.47%	-1.70%	$(96.26)
FY 2028	13.15%	11.44%	-1.71%	$(99.93)

Applying the new, lower employer contribution rate to the project State/School group payroll (approximately $5.0 billion in FY 2024) totals reduced contributions between $88 million and $100 million in the first five years after the bond proceeds are received by the Trust Fund. Over the 30-year projection period, total employer contributions are projected to be $12.11 billion, which is $1.4 billion less than the $13.56 billion projected under the current financing plan. The total difference is greater than the $1.0 bond proceeds because the assets are in the Trust Fund earlier and allowed to grow with investment returns over a longer period.

A $500 million pension funding bond would also improve the funded status of the System by about half as much as the impact of a $1.0 billion pension funding bond. The

State/School funded ratio with the addition of $500 million is projected to increased by 2.4% (from 71.9% to 74.3%) in the 12/31/2021 actuarial valuation. The additional assets would reduce the FY 2024 State/School employer contribution rate by 0.83%, or about $43.8 million from all funding sources in FY 2024. The impact on the State/School employer contribution rate would be similar in future years.

Past Pension Funding Bond Issues

The Legislature has issued pension funding bonds on two previous occasions to improve the funded status of the System. The first pension bond issue was approved in 2004 and was $500,000,000 gross of fees. KPERS ultimately received about $440 million in bond proceeds. The second bond issue was approved in 2015 for $1,000,000,000, net of fees. Both bond issues are 30-year taxable bonds and the debt service is paid outside of KPERS.

The proceeds from the bond issuances are invested across KPERS portfolio consistent with the Boards asset allocation and investment practices. KPERS does not track the bond proceeds separately from the rest of the Trust Fund, but we do track the Trust Fund performance since the date of receipt.

Past performance does not guarantee future performance, but so far both bond issues have added value to KPERS Trust Fund and the State of Kansas. As of February 28, 2021, the investment returns of the Trust Fund have outperformed the bond rate on both bond issues. The total value added, after paying the debt service on the bonds, is $775 million.

Performance of Existing Pension Funding Bonds		
Bond Issue	March 2004	August 2015
Total Proceeds Received	$440 million	$1.0 billion
Investment Return Since Deposit Date (As of January 31, 2021)	7.72%	8.64%
Interest Rate on the Bonds	5.39%	4.68%
Value Added After Debt Service	$482 million	$293 million

Both bond issues are 30-year bonds and the ultimate value will not be known for many more years, but so far, the pension funding bonds approved by past Legislatures have been a net positive for the State of Kansas.

I would be pleased to answer any questions the Committee has regarding HB 2405.